

BEFORE THE AGRICULTURAL MARKETING SERVICE
UNITED STATES DEPARTMENT OF AGRICULTURE

June 20, 2005

In the Matter Of:

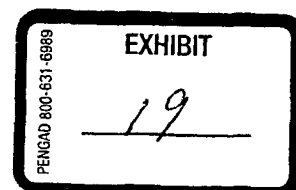
PROPOSED AMENDMENT TO TENTATIVE
MARKETING AGREEMENTS AND ORDERS

Docket No. AO-14-A73 *et al.*;
DA-03-10

TESTIMONY OF SIMON TUCKER, FONTERRA (USA)

Good morning. For the record, my name is Simon Tucker. I am the Vice President, Government Relations and Trade, North America, of Fonterra Co-operative Group Limited. I very much appreciate the opportunity to appear before you today, to discuss several issues of concern to Fonterra (USA), a wholly-owned subsidiary of Fonterra Co-operative Group Limited. Fonterra (USA) is headquartered just outside of Harrisburg, Pennsylvania, a little ways down the Pennsylvania Turnpike from where we are today.

First, I think a bit of background might be useful. Fonterra Co-operative Group Limited is a New Zealand based, multinational dairy company. As well as supplying fresh milk to New Zealand consumers, we manufacture and export dairy ingredients and consumer products to over 140 countries worldwide. While Fonterra is New Zealand's largest company, we produce only about 2% of world milk production, less than either California or Wisconsin. That Fonterra is the world's largest exporter of dairy products reflects the small number of domestic consumers in New Zealand, our ideal conditions for producing milk, and our innovative approach to dairy processing and product development. The company is owned by 12,000 mostly family dairy



farmers in New Zealand, who produce milk predominantly through pastoral farming. These farmers compete in one of the world's most open economies. They receive no direct producer support from the New Zealand government, no export subsidies, and no protection from imports. Given the wholesale deregulation of the New Zealand dairy industry in 2001, including the abolition of the New Zealand Dairy Board, Fonterra faces competition within New Zealand from milk supply and competes with other New Zealand companies in dairy export markets.

Fonterra has a longstanding relationship with the U.S. market, and a significant presence here on the ground. We are part of the fabric of the U.S. dairy industry, both as a supplier of quality dairy ingredients, and through the manufacture and export of dairy products, produced in the U.S., from U.S. milk. Partnering with some of the key players in the U.S. dairy industry has led Fonterra to make significant investments in capital and intellectual property in the United States. For example, through our partnership with Dairy Farmers of America, we are manufacturing dairy products at ten sites across the country, including the first plant to manufacture milk protein concentrate in the United States. Located in Portales, New Mexico, this plant, which was manufacturing milk powder that went mostly to federal storehouses, is now profitably supplying product to American customers. Such is the success of this plant that this year we will commence exporting U.S. MPC to Mexico.

As an unsubsidised exporter that enjoys no governmental protection, Fonterra has had to make its living by trading in the international marketplace and living off of those returns. It has brought that experience to the U.S., as well as other markets, where we seek to work cooperatively with dairy farmers and companies to increase dairy consumption — to grow the dairy pie so that we can all have a larger slice. Fonterra's investments in the U.S. which I have just described, reflect this philosophy. It also leads to our concerns with the proposals before you.

Whether they are supermarket chains or global food manufacturers, customers have two fundamental requirements of their suppliers. First is that we help them respond to consumer trends, and second that we enable them to do this cost effectively and profitably. In meeting these requirements there is no doubt that there are some forces that dairy must vigorously resist because these will dictate our development, in this case for the worse, not better. To see this, one need only walk through any supermarket and look at the products positioning themselves directly as dairy substitutes. We see products made of soy, rice, nuts, grains and oils, all marketed with the names consumers have always associated with dairy. Many of these products are aggressively marketed, some with scientifically based health claims being made and verified, to encourage demand and to position these products as a superior choice over dairy. The claim by the soy industry linking soy to reducing the risk of heart disease has FDA approval. Scandinavian authorities have approved a health claim for cheese where all the milkfat has been replaced by canola oil.

You may well ask what does that have to do with the issues before you today? The answer, I think, is straightforward. To the extent that the proposals you are considering would impose an upcharge on dairy ingredients, they serve as a disincentive to our customers to purchase dairy ingredients for their products. It is a simple market reality that if you offer a customer an ingredient which will drive up his or her cost of manufacture vis-à-vis a competing ingredient, you are at a marketing disadvantage and will eventually lose market share. And such loss of market share is not theoretical. The table included in my testimony shows that in nutritional applications alone, between 1999 and 2003 the use of soy protein in nutritional applications has enjoyed an average annual growth rate of 16.5%, while milk protein has increased by only 10.1%. Soy is clearly eroding the dominant market position in these products once enjoyed by milk protein.

Protein Growth in Nutrition

	1999	2003	CAGR
Total Protein	76,350	119,505	11.9%
Milk Protein	56,580	83,137	10.1%
<i>Casein</i>	35,230	50,234	9.3%
<i>Whey</i>	21,350	32,903	11.4%
Soy	19,770	36,368	16.5%

We understand the concern voiced by many here that some innovative beverage products which contain milk ingredients but are not currently Class I products, may compete with Class I milk, and if not assessed a Class I upcharge, have an advantage in that competition. However, we would caution, in the words of the old adage, "be careful what you ask for." Until far more is known about the nature of competition in the overall beverage market and the position of these various new beverages in that competitive framework, one may well level the playing field with fluid milk in, say, 10% of the market, but create a disadvantage for milk ingredients in 90% of the market, a result which benefits no-one in the dairy sector. We would also caution that this type of regulatory constraint creates a disincentive to innovation in the dairy sector which places the dairy industry at a long-term and significant disadvantage to other sources of protein, notably soy.